INTERNATIONAL SOVEREIGN
ENERGY CORP.

2004 Annual Report

Annual Meeting

The Annual General & Special Meeting of shareholders of the Corporation will be held on Wednesday, May 11, 2005 at 2:30 p.m. in the Solan Pommard room at the Sutton Place Hotel, 845 Burrard Street, Vancouver, British Columbia. Shareholders and members of the public who are interested in receiving additional information on the Company are encouraged to attend.

Abbreviations

ARTC	Alberta Royalty Tax Credit
bbl	barrel
bbls/d	barrels per day
bcf	billions of cubic feet
boe	barrel of oil equivalent (1 bbl = 6 mcf)
bopd	barrels of oil per day
m	thousands
mcf	thousands of cubic feet
mm	millions
mmcf	millions of cubic feet
NGLs	natural gas liquids

Corporate Profile

International Sovereign Energy Corp. is a Canadian based publicly traded exploration and production company with offices in Vancouver, British Columbia; Calgary, Alberta and Islamabad, Pakistan and is active in the exploration and development of hydrocarbon reserves in Western Canada and internationally.

The Company, incorporated in 1992, owns and operates a strong asset base of producing oil and gas properties in Western Canada that it continues to expand through the drilling of internally generated low to medium risk exploration and exploitation opportunities. This conservative, low risk approach in Western Canada provides the Company with a substantial asset base from which to identify and pursue late stage exploration or early stage development opportunities internationally.

The Company is committed to maximizing shareholder value through the rapid growth expected from its international initiatives as well as through increasing its Western Canadian reserve base.

The shares of the Company are publicly traded on the TSX Exchange under the symbol "ISR". At year-end 2004, the company had 8,888,082 shares issued and outstanding.

Highlights Year in Review

	2004	2003
OPERATING		
Production		
Oil & NGLs (bbls)	**107,192**	174,576
Per day	**293**	478
Natural Gas (mcf)	**536,885**	498,084
Per day	**1,467**	1,365
Exit Production		
Oil & NGLs (bopd)	**298**	496
Natural Gas (mcf per day)	**1,547**	1,822
Proven and Probable Reserves		
Oil & NGLs (mbbls)	**988**	1,603
Natural Gas (mmcf)	**9,459**	5,475
Average Price Received		
Oil ($ per bbl)	**34.80**	28.87
Natural Gas ($ per mcf)	**6.15**	5.78

	2004	2003
FINANCIAL		
Gross Revenue	**$ 7,109,199**	$ 7,977,939
Cash Flow	**3,059,782**	3,769,673
Per Weighted Average Share	**0.39**	0.56
Net Income	**341,512**	1,392,481
Per Weighted Average Share	**0.04**	0.21
Capital Expenditures	**4,968,831**	4,511,325
Acquisitions	**0.00**	0.00
Divestitures	**918,672**	141,830
Long Term Debt	**0.00**	0.00
Net Asset Value (15% DCF)	**23,571,739**	18,847,990
Per Share	**$ 2.65**	$ 2.65
Class A Common Shares		
Issued at Year End	**8,888,082**	7,101,036

For the purpose of cash flow per share calculations, cash flow is defined as "Cash flow from operations" before the changes in non-cash working capital. This definition is not a recognized measure under Canadian generally accepted accounting principles and accordingly may not be comparable to measures used by other companies.

Lutfur Rahman Khan
President and Chief Executive Officer

President's Message

Operational Review

During the past year, your Company remained focused on driving shareholder value through continued domestic western Canadian production and reserve base growth, as well as by advancing its higher impact international initiatives and by increasing the Company's profile within the investment community.

Domestically, the Company advanced its strong inventory of gas prospects in the Lacombe, Chigwell, Medicine River, Little Bow and Sturgeon Lake areas of Alberta. A 75% drilling program success rate on a gross well basis (61% net) was achieved with six of the eight wells drilled in 2004 being cased for potential gas production. The net result was a 73% increase in the Company's gas reserves resulting in a modest reserve increase overall compared to 2003, after taking into account the watering out of the Company's heavy oil property at Marwayne. Consequently, the Company's reserves split changed to 24% heavy oil from 53% while gas reserves increased to 62% compared to 36% in 2003.

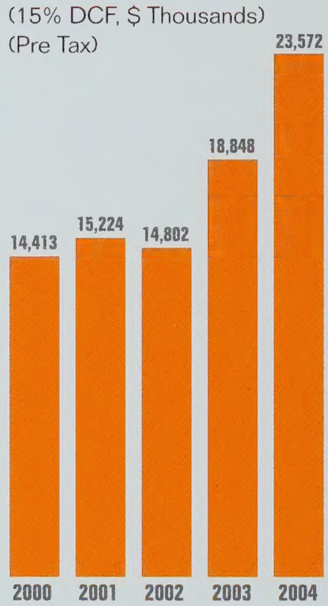
In 2005, the Company will continue to develop new prospects in its current areas of interest as well as add new prospect areas such as Wizard Lake, Alberta where seismic and land acquisition is proceeding. At Medicine River, the Company will be drilling a 100% working interest Devonian test, twinning a well drilled in the early 1950's that had indicated gas and oil reserves in both the Nisku and the Leduc formations and tying in a second 50% working interest well that tested gas at rates up to 6.0 MMcf/d from the Leduc.

Internationally, the Company's activities remained centered on late stage exploration, early stage development and existing field optimization projects. In Pakistan, the Company has developed strong relations at the highest levels in both the Government of Pakistan and the national oil company, Oil and Gas Development Company Limited ("OGDCL"). A Memorandum of Agreement ("MOA") was signed with OGDCL for the exploitation of Paleocene and Eocene upper carbonates in the Toot oil field. The Toot field is located in the prolific oil producing Potwar region of northern Pakistan, approximately 135 km southwest of Islamabad.

In Ecuador, the Company entered into an agreement giving it the right to acquire 100% of the Charapa concession located in the Ecuadorian Oriente Basin on the Colombian border. The concession has light oil exploration potential associated with the seismically indicated un-drilled Conejo structure and exploitation potential of the Charapa structure which has proved undeveloped oil in place in the Hollin formation, the major producing reservoir in the country. The Company continues to maintain its unique relationship with the "Federation of the Union of Communities of the Ecuadorian Amazon" through a Memorandum of Understanding, ensuring the participation and cooperation of the indigenous communities in additional projects that the Company is pursuing in Ecuador.

Net Asset Value

(15% DCF, $ Thousands)
(Pre Tax)



In the first quarter of 2004, the Company graduated to the Toronto Stock Exchange from the Venture Exchange and in August, 2004 completed a private placement of 1,617,621 shares at $1.50 per share. Subsequent to the year-end 2004, the Company closed a further private placement in February 2005, consisting of 2,069,000 shares at a price of $3.00 per share for net proceeds after commissions and costs of $5,727,510.

From Left to Right:
Donald G. Campbell, Sr. Vice President Engineering & Production and Chief Operating Officer;
Waseem Rahman, Sr. Vice President Administration and Corporate Secretary;
Timothy Hoar, Legal Counsel;
Omair Choudhry, Sr. Vice President Finance and Chief Financial Officer;
Lutfur Rahman Khan, President and Chief Executive Officer;
Rodney Duncan, Corporate Development;
George P. Bowley, Sr. Vice President Exploration & Development

Outlook

International Sovereign is anticipating an active 2005. The Company will participate as to its working interests, ranging from 39% to 50% in the completion of three wells in the Lacombe/Chigwell area in the first quarter of the year. Additionally, the Company will participate in the completion of a recently drilled well in the Ante Creek area of Alberta in which the Company holds a 25% working interest. All four of these wells have been recently cased. Production from successful completions on these wells should commence in the first and second quarters of the year.

In Medicine River, the twinning of an existing producer for uphole potential from two additional zones (~46.5% working interest) and the re-completion of an existing marginal producer (~63% working interest) for Glauconite zone potential is expected to occur after spring breakup. Also in Medicine River, the Company expects to drill in the second half of 2005, a 100% working interest Devonian test, with indicated gas and oil reserves in both the Nisku and Leduc zones. A 10 km sour gas pipeline will be required to tie-in the newly drilled well, as well as a second, ~50% interest Leduc well that has tested gas at rates up to 6.0 MMcfd. The Company expects production from these wells in the fourth quarter 2005.

The Company has also generated several Mannville prospects in the general Wizard Lake area of central Alberta. Seismic and land acquisition and negotiations are proceeding, and field activity on these prospects should commence as early as the second quarter of 2005.

On the international front, the Company's negotiations with PetroEcuador to reform the terms of the work program of the Charapa concession are at an advanced stage. Upon final agreement, the Company plans to commence a 3D seismic survey followed by a horizontal re-entry operation into the Hollin formation from an existing wellbore in the Charapa field.

In Pakistan, the Company executed a Memorandum of Agreement with the Oil & Gas Development Company Limited for the exploitation of the upper carbonate zones in the Toot oil field located in the Potwar region. The technical studies associated with Stage 1 of the project are underway.

Subsequent Events

In January 2005 the Company announced that a Memorandum of Agreement was signed with the Oil and Gas Development Company Limited, the national oil company of Pakistan, for the exploitation of the upper carbonate zones in the Toot oil field located in the Potwar region, Punjab Province, which is near the capital city of Islamabad.

In February 2005 the Company closed a private placement consisting of 2,069,000 common shares at a price of $3.00 per share for gross proceeds of $6,207,000. The agent for the private placement was paid a cash commission equal to 7% of the proceeds of the private placement. Net proceeds after all commissions and costs were $5,727,510. In addition the agent and its sub-agents were issued compensation warrants to acquire up to an aggregate of 206,900 common shares exercisable for a period of two years at an exercise price of $3.35 per share. All the issued shares are subject to a four months hold period expiring June 23, 2005.

On behalf of the Board of Directors, I would like to thank shareholders for their support and confidence and I look forward to reporting on some exciting new developments both domestically and internationally in the year ahead.

Lutfur Rahman Khan
President and CEO

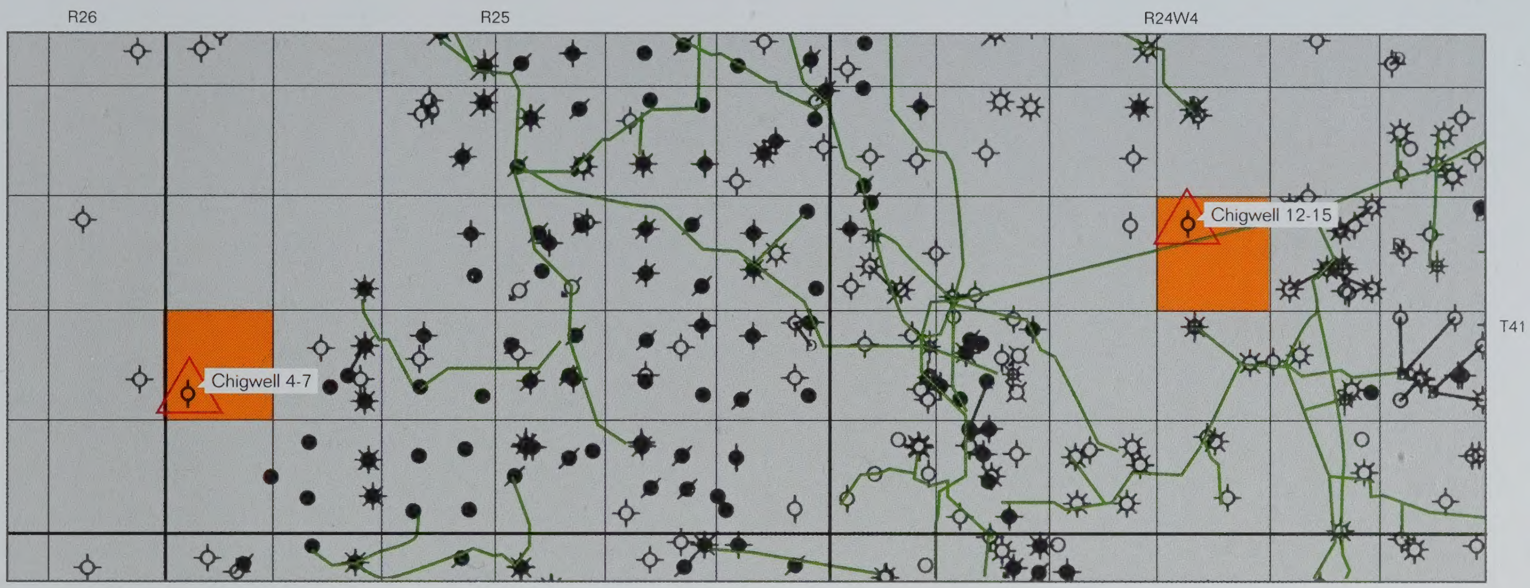
March 16, 2005

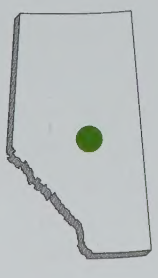
Operations and Production

The Company's drilling program for 2004 was weighted entirely towards increasing its natural gas production in order to achieve a more balanced product mix. International Sovereign participated in a total of seven drilling and one re-entry operations resulting in six wells being cased for gas production and two abandoned for a success rate of 75% on a gross well basis (61% net).

A total of $2.04 MM was spent in 2004 on drilling, completions, re-entries, equipping and tie-ins during the year while work-overs, primarily associated with Marwayne, accounted for another $351 M. Seismic expenditures for the year totaled approximately $200 M with the acquisition of approximately 65 line kilometers of trade and proprietary seismic data. Land acquisition totaled $400 M and increased the Company's inventory by 12,930 gross acres (5,862 net) while routine inspections, remediations, abandonments and reclamations added another $60 M bringing the total AFE'd domestic expenditures on operations for the year to approximately $3.05 MM.

Average gas production increased 7% to 1,467 MMcf/d while average oil production was down from the year prior as a result of the loss of the GP heavy oil production at Marwayne. New gas production coming on-stream from this year's drilling program is expected to restore total production to its former level early in 2005.

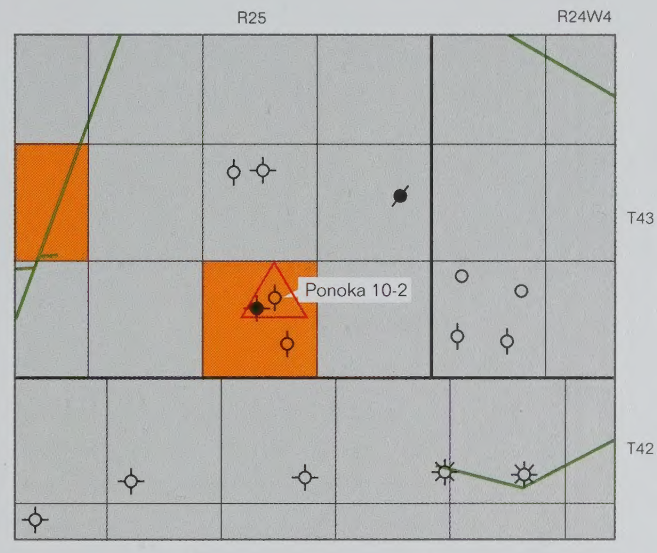


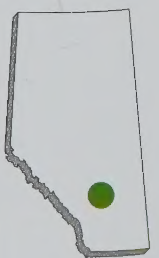


Lacombe-Chigwell

Regional geological mapping of potential gas bearing lower Mannville channel systems was concluded early in the year and land acquisition and farm-ins proceeded on three seismically defined prospects. The Ponoka 10-2 well was drilled in August and was cased for lower Mannville and basal Belly River gas potential and is currently waiting on tie-in of an Ellerslie zone. Drilling of the 4-7 and 12-15 wells at Chigwell could not commence until December and although no commercial gas zones were encountered in the primary target both wells were cased for up-hole gas potential and are standing pending further evaluation.

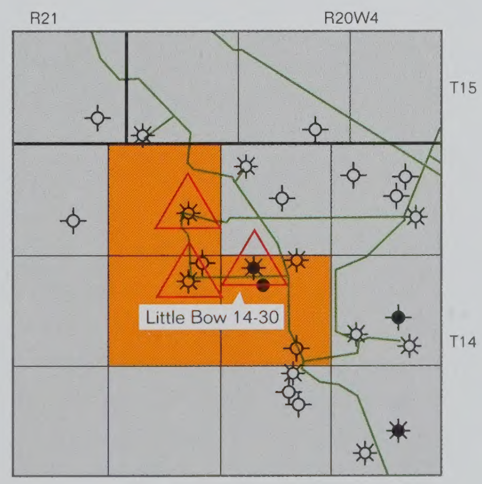
The Company continued its emphasis on prospecting for gas and expanded its area of interest northward to the Wizard Lake area. Geologic mapping has identified a number of promising leads and seismic and land acquisition is underway to mature several drillable prospects for the upcoming year.



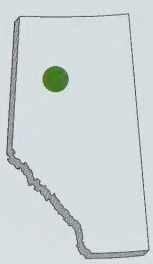


Little Bow

A third successful 44% working interest well was drilled into the Company's Bow Island sand gas property at Little Bow in June and the well was brought on-stream in September. Compression to optimize the Company's share of the pool's withdrawls was added late in the year and December saw an increased exit production exit rate of 410 Mcf/d net to the Company's interest, up 20% prior to compression.

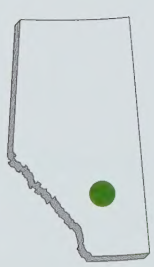


Company Working Interest Lands



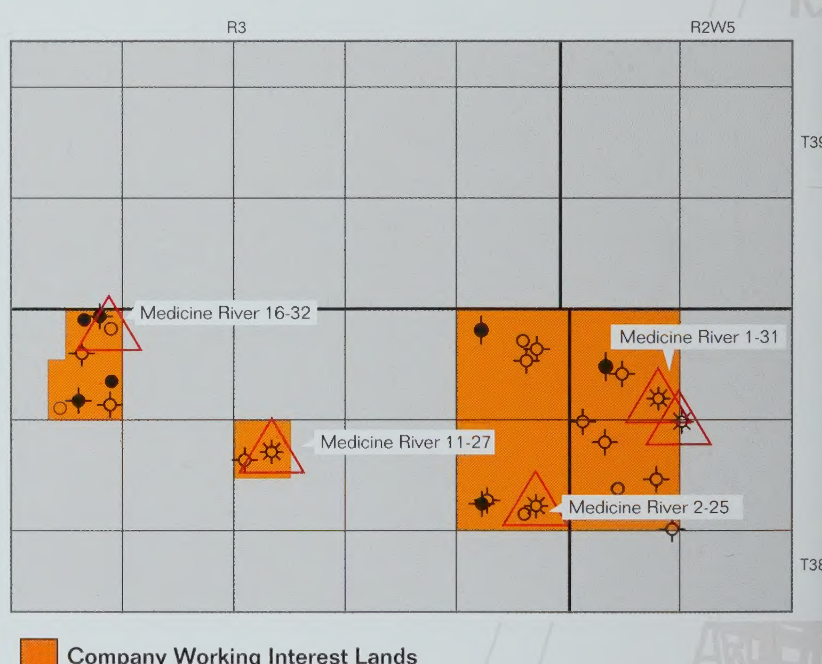
Ante Creek

The Company participated as to a 25% working interest in two wells in the Ante Creek area and a third that was planned but did not spud until January, 2005. All three wells targeted bypassed pay in the lower Mannville and were all cased as potential gas wells. The 11-15 well, cased as a dual-zone Cadomin and Gething gas well was put on production in July from the Cadomin at 700 Mcf/d and was switched over to Gething production at 1,000 Mcf/d in November. The 10-36 well was cased for Gething gas potential in the spring but could not be production tested due to access restrictions until the first quarter, 2005. The well is currently waiting on a re-completion in the Gething. The third well in the program at 15-8 has an indicated 10 m of gas pay in the Gething and will be completed and tied in for production early in the upcoming year.



Medicine River

The Medicine River area continues to be active for the Company. A 50% working interest Edmonton sand gas well was drilled mid-year and came on production at an initial rate of 400 Mcf/d. Upcoming operations for the area include the drilling of a 46% working interest twin to an existing producer for Colony and Edmonton sand gas potential, the drilling of a 100% working interest Leduc twin that tested 8.7 MMcf/d and the tie-in of a Leduc gas well on a recently acquired freehold lease that tested 6.0 MMcf/d. The construction of a 10 km pipeline is required to tie-in the Leduc gas to the area's sour gas infrastructure.



International Highlights

Toot Concession

Pakistan

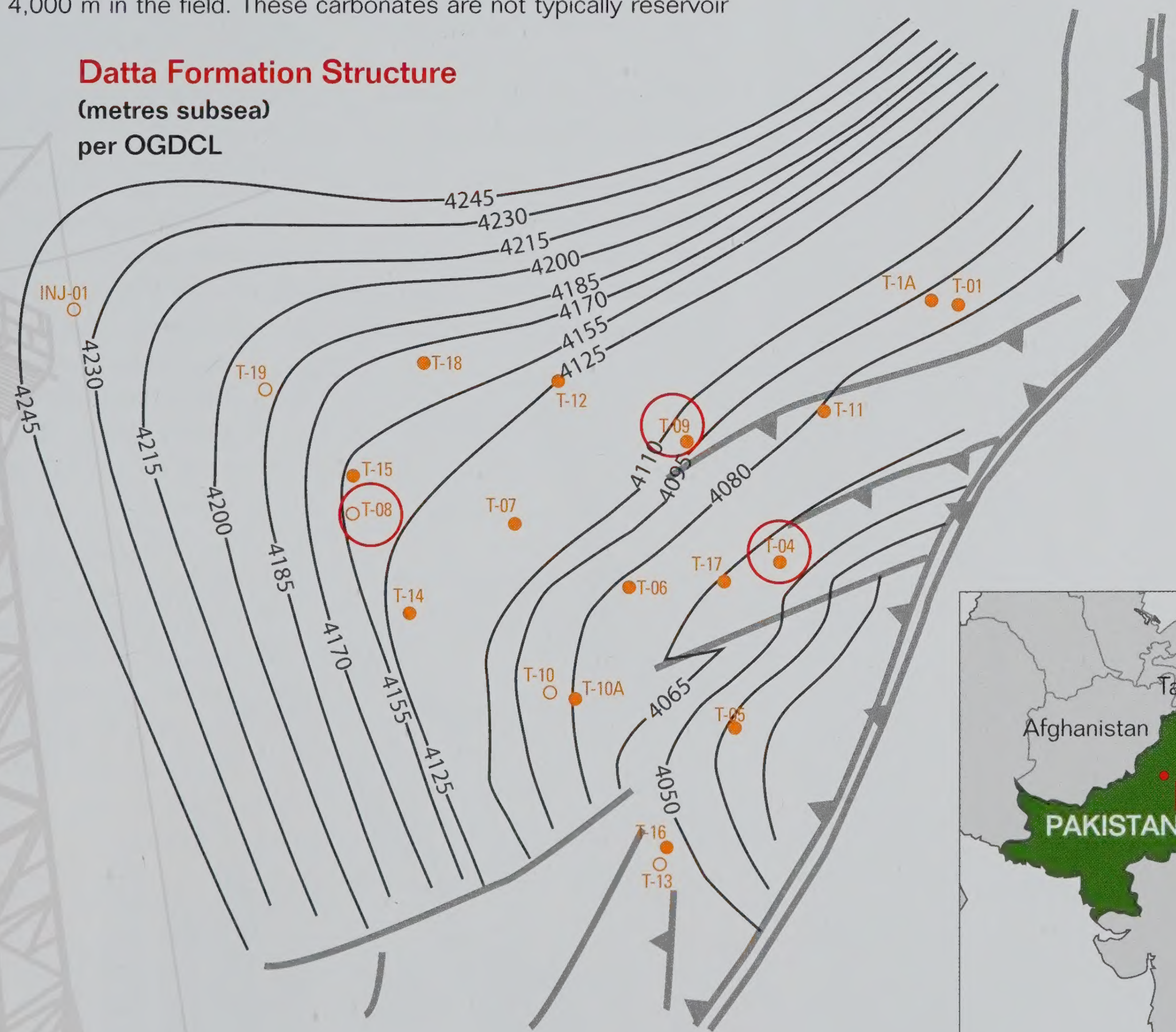
The Toot oil field is located approximately 135 km southwest of the capital city of Islamabad in the Potwar region of northern Pakistan. The field was first drilled on the basis of geologic field mapping which identified a gentle east-west trending surface anticline that was tested in 1964 with the drilling of the Toot 1 well. The discovery well encountered oil in the Jurassic Datta sands at a depth of 4,450 m and was completed in 1967. At its peak during 1986, the field was producing approximately 2,400 bopd, from a productive area of 12 square km, primarily from the Datta sands. The Datta sand reservoir is currently in the late stages of depletion after producing over 12 million barrels of oil and 33 bcf of associated gas.

Of interest to the Company is the 350 m thick sequence of Paleocene (Patala and Lockhart formations) and Eocene (Sakessar and Chorgali formations) interbedded carbonates and shales overlying the Datta sand and commencing at about 4,000 m in the field. These carbonates are not typically reservoir grade and must rely upon the development of microfractures and an interconnected system of fractures from which to produce.

If the fracture system is present, the wells can be very prolific, as is evidenced by the success at Fimkassar 100 km to the east, where a sidetrack to an oil show in a vertical well in the Eocene carbonates produced 11 million barrels of oil and 10 bcf gas over a 15 year period. Three wells in the Toot field have indicated that a fracture system may be developed in the carbonates. Toot 9 produced approximately 135 Mbbls of oil while Toot 4 produced 380 Mbbls, both from the Chorgali formation while Toot 8 blew out in the Sakessar formation while drilling and burned down the rig.

The Company recently signed a farm-in agreement with the national oil company (OGDCL) for the evaluation and potential exploitation of the fractured carbonates in the Toot field.

Datta Formation Structure
(metres subsea)
per OGDCL



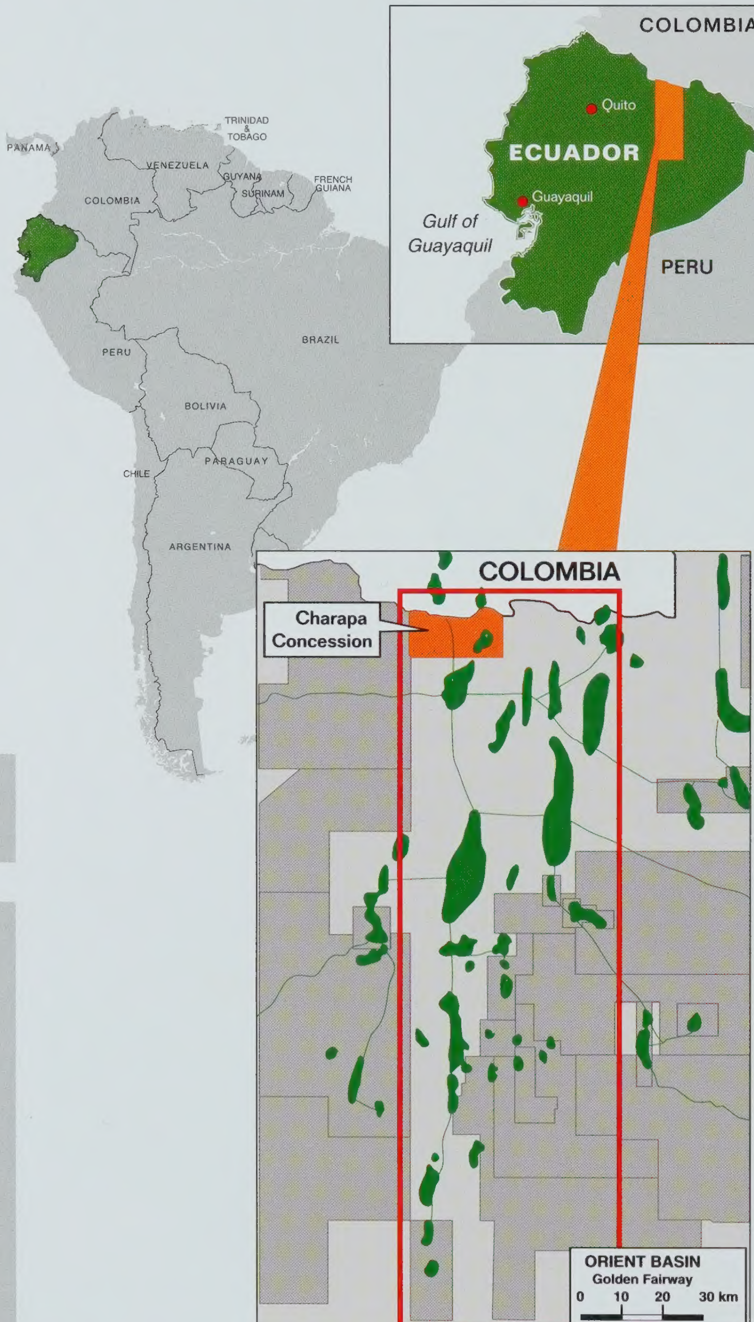
Hydrocarbons Indicated from Fractured Carbonate

Charapa Concession

Ecuador, South America

In May of this year, the Company entered into an agreement with a private Alberta corporation giving it the option to acquire for a 12 month period, a 100% interest and operatorship in the Charapa concession by acquiring 100% of the shares of a wholly owned subsidiary of the vendor and by fulfilling the remaining work obligation on the concession, which is currently the subject of renegotiation.

The concession is located in the north of Ecuador's prolific Oriente Basin on the Colombian border. The field lies at the north end of Ecuador's famed Golden Fairway and immediately north of the Lago Agrio field which is a fault bounded anticline and contains an estimated 500 million barrels light oil in place. Lago Agrio has produced 145 million barrels since 1972, primarily from the Cretaceous Hollin Formation.

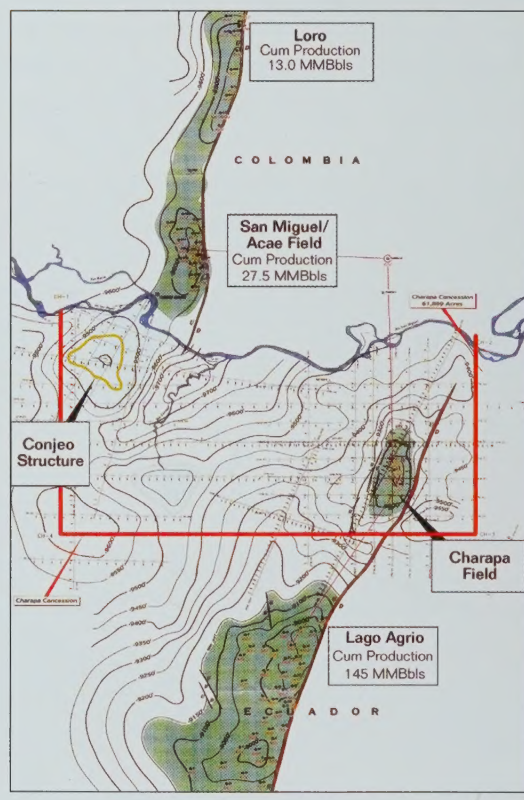


The Charapa 1 discovery well was drilled in 1967 and encountered light oil in the Cretaceous Caliza B, a fractured limestone reservoir and in the slightly deeper Hollin sands. The well tested 200 bopd from the Hollin but never produced until 1981 when it was completed as a producer in the Caliza B. Three additional wells were drilled into the structure for Caliza B but were unsuccessful. All four wells however, indicated oil pay in the Hollin, but the formation was never put on production.

The concession was acquired by the vendor through its subsidiary from PetroEcuador, the national oil company, in a marginal bid round in 1999. At the time, the concession was producing a minor amount of oil from the Caliza B. A number of horizontal wells were drilled into the limestone in an effort to intersect additional fractured reservoir but were unsuccessful. Subsequent re-completions in the Hollin were unsuccessful due to well bore problems.

The Charapa concession offers a unique opportunity in that it offers both exploration and exploitation potential. The Hollin sands provide the exploitation component where an independent reserve report for the field has attributed up to 38 million barrels of light oil in place and recoverable potential in excess of 9 million barrels. A transient test done by Schlumberger in 2001 on the discovery well indicated production rates from vertical wells of 800 bopd could be achieved if skin damage could be eliminated.

The seismically defined but as yet un-drilled Conejo structure provides an exciting exploration component to the concession. Located 16 km to the west of the field and 6 km from a major pipeline, the Conejo structure is bounded to the east by a pronounced reverse fault similar to and on trend with the fault system that sets up the 27.5 million barrel San Miguel/ Acae field just north of Conejo in Colombia.



The Company continues to negotiate with the production division of the national oil company regarding reforms to the current work program for the concession.

Reserves

International Sovereign Energy Corp.'s oil and gas reserves are determined by the independent petroleum consulting firm of Chapman Petroleum Engineering Ltd.

The Company experienced a marked shift in the make-up of its reserves during 2004. Gas now comprises approximately 62% of the proved plus probable reserve base and 55% of the total proved reserves, whereas the year prior gas accounted for only 36% of the proved plus probable reserves. The shift came at the expense of the Company's heavy oil component of reserves that formerly accounted for over half of the Company's proved plus probable reserves but currently represents approximately 24%. The Company replaced its annual production and the loss of approximately 700 mbbls of proved plus probable heavy oil reserves at Marwayne with 760 mboe new proved plus probable gas reserves which increased the net present value of the Company's reserves by 24% (at a 10% discount).

Total proved plus probable reserves increased a modest 2% over the January 2004 levels while proved plus probable gas reserves jumped 73% over the year prior. Based on the Company's average production rates and proved plus probable reserves, our reserve life index is approximately nine years for oil and natural gas liquids and 17 years for natural gas.

The table below presents the Company's proved plus probable reserves before royalties as evaluated by Chapman Petroleum Engineering Ltd. as at January 1, 2005.

Reserves

	Proved	Probable	Total
Gas (MMcf)	3,250	6,209	9,459
Light & Med. Oil (mbbls)	126	89	215
Heavy Oil (mbls)	301	323	624
NGLs (mbls)	14	135	149
Total (mboe)	983	1,582	2,565

The table below represents the discounted net present value of future net revenue of the Company's reserves as at January 1, 2005.

Present Value of Reserves

$ Thousands Present Value, before tax, discounted at	10%	15%
Proven	12,064	10,638
Probable	15,431	12,477
Total	27,496	23,115

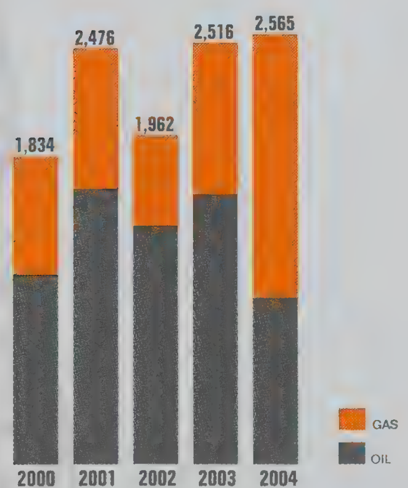
Chapmam Petroleum Engineering Ltd. conducts continual surveillance and monitoring on a number of Benchmark product prices both locally and internationally. Based on historical data, current conditions and their view of the relevant political and economic trends, they independently prepare oil, gas and by-product price forecasts.

In establishing their forecasts they also consider input from operating companies, consulting firms, oil & gas marketing companies and financial institutions. The forecasts are updated quarterly and the most current one has been utilized for this report and is presented below.

	Gas Reference Price ($Cdn. per mmbtu)		Crude Oil Edmonton Light Sweet ($Cdn. per bbl)	
	Effective 1/1/05	Effective 1/1/04	Effective 1/1/05	Effective 1/1/04
2005	6.25	5.00	50.22	35.50
2006	6.00	4.75	49.00	34.17
2007	5.50	4.75	47.72	32.83
2008	5.25	4.75	45.15	33.33
2009	5.33	4.75	43.87	33.83
2010	5.41	4.75	44.54	34.33
2011	5.49	4.82	45.23	34.85
2012	5.57	4.89	45.92	35.37
2013	5.66	4.97	46.63	35.90
2014	5.74	5.04	47.34	36.44
2015	5.83	5.12	48.06	36.99

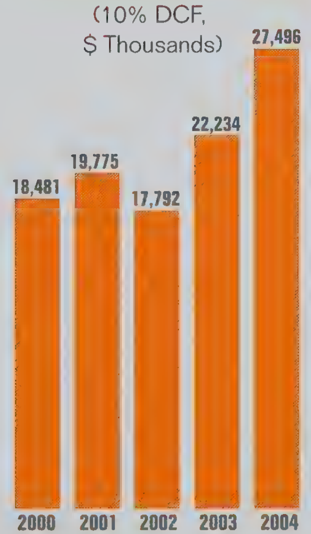
Reserves

Proved Plus Probable
(MBOE, 6:1 Conversion)



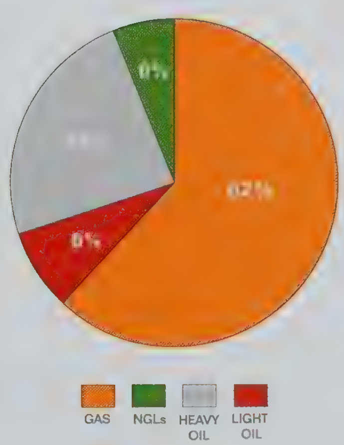
NPV of Proved Plus Probable Reserves

(10% DCF, $ Thousands)



Reserve Allocation

Proved Plus Probable
(6:1 Conversion)



Management's Discussion and Analysis

as at March 11, 2005

The following is management's discussion and analysis ("MD&A") of International Sovereign's operating and financial results for the periods ended December 31, 2004 and 2003 as well as information concerning the Company's future outlook based on currently available information. This MD&A should be read in conjunction with the Company's December 31, 2004 and 2003 consolidated financial statements and related notes.

Forward-Looking Information

This MD&A contains forward-looking or outlook information which reflects management's expectations regarding the Company's growth, results of operations, performance and business prospects and opportunities. The use of words such as "anticipate", "continue", "estimate", "expect", "may", "will", "project", "should", "believe", "outlook", "forecast" and similar expressions are intended to identify forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results of events to differ materially from those anticipated in these forward-looking statements. Although management believes the expectations reflected in these forward-looking statements are reasonable, there can be no assurance that actual results will be consistent with these forward-looking statements. Readers should not put undue reliance on forward-looking information. These statements are made as of the date hereof and management assumes no obligation to update or revise these statements to reflect new events or circumstances.

Production and Revenue

Revenues for the twelve month period were $7,109,199, a decrease of 11% from the 2003 level of $7,977,939. Average production over this period decreased from 705 boe/d in December of 2003 to 538 boe/d by December of 2004. Average oil production decreased by 185 bopd, from 478 bopd in the corresponding period of 2003 to 293 bopd at the end of December 2004. The major contributing factor to this decline was the watering out of GP production in the Marwayne heavy oil field in March and April of 2004. However, during this same period average gas production increased 7% from 1,365 mcf/d at December 31, 2003 to 1,467 mcf/d at December 31, 2004 (227 bopd equivalent to 245 bopd equivalent, an increase of 24 bopd equivalent). This increase is primarily from the addition of gas wells of varying working interests in the Fort St. John area in British Columbia and the Little Bow, Ante Creek and Medicine River areas in Alberta. The main contributing factor to revenues declining at a lesser rate than production, is that oil prices rose from an average of $28.87/bbl in 2003 to $34.80/bbl in 2004. Average gas prices also increased in the same period averaging $6.15/mcf in the twelve months of 2004, compared to $5.78/mcf average price in the corresponding period of 2003.

Royalties

Royalties, net of Alberta Royalty Tax Credit decreased from $1,088,134 at December 31 2003 to $988,285 at December 31, 2004, which reflects a 10% decrease. However, royalties as a percentage of revenues remained flat at 14% in both 2004 and 2003. Although gas production and gas prices both rose slightly which would increase gas royalty rates, this was offset by the drop in oil production and a corresponding royalty rate reduction, resulting in a flat overall rate.

Operating Costs

Operating costs totalled $1,710,637 in the twelve months ending December 31, 2004, which equates to $8.70/boe, up from $6.42/boe in the same period of 2003. This increase is mainly attributable to the Marwayne heavy oil wells, which have incurred higher overall operating costs in 2004, as several of the wells have experienced increased workover expense and additional water handling costs, as a result of the watering out of several wells in the GP zone. Also, additional operating costs were incurred on some of the new gas wells in order to optimize production.

General and Administrative

Total general and administrative expenses increased 10% from $1,196,771 in the twelve months ending 2003 to $1,322,207 in the same period of 2004. This was the result of increased activity within the Company, requiring increased technical consulting services both for domestic and foreign prospects. Also, as a result of increased staffing the Company acquired additional office space in December 2003.

Interest

The 2004 interest expense was down from $6,675 in 2003 to $810 in 2004. This interest expense is principally miscellaneous interest on daily transactions and not bank interest. In 2003 and 2004 due to increased cash flows it has not been necessary to use the available line of credit, except to a very minor extent. At December 31 of 2004, the available line of credit of $4,150,000 was not drawn upon.

Depletion and Depreciation and Accretion

Total depletion, depreciation and accretion provision was up from $2,235,138 in the year ending December 31, 2003 to $2,741,387 for the same period 2004, representing an increase of 23%. This increase was due, in part, to capitalized costs of $787,254 related to the impairment of certain international cost centers having been charged to depletion. Had depletion been calculated prior to this charge, and also prior to the addition of accretion expenses as a result of the new Asset Retirement Obligation calculation, the depletion rate for the year ending 2004 was $9.52/boe, up from $6.24/boe in the corresponding period of 2003. This was due in part, to a reduction in total proved developed reserves from the year end 2003 level of 1,521,667 boe, compared to 982,835 boe at the end of 2004.

Asset Retirement Obligation

In January 2004 the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented for comparative purposes. This standard requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the date of expected settlement of the retirement obligations. The new standard is effective for all fiscal years beginning on or after January 1, 2004.

Previously, International Sovereign recognized a provision for future site reclamation and abandonment costs calculated on the unit-of-production method over the life of the petroleum and natural gas properties, based on total estimated proved reserves and the estimated future liability.

As a result of this change net income for the year ended December 31, 2003 increased by $9,286 ($16,838, net of a future income tax expense of $7,552). The Asset Retirement Obligation ("ARO") increased by $43,410, PP&E net of accumulated depletion increased by $60,249 and the future income tax liability increased by $7,552. Opening 2003 accumulated earnings increased by $32,895 ($51,023, net of a future income tax expense of $18,128) to reflect the cumulative impact of accretion and depletion expense, net of the cumulative site restoration provision, on the asset retirement obligation recorded retroactively to 1994. The opening ARO in 2003 increased by $234,779.

For the year 2004 the ARO increased by $113,822 ($118,601 less actual abandonment costs of $4,779), PP&E increased $55,369 net of depletion, and net income decreased $104,056 to reflect the impact of accretion and depletion expense for the period.

Capital Expenditures

Total capital expenditures in the year 2004 were $4,968,831 up 10% from the December 31, 2003 number of $4,511,325. This increase was the result of increases in spending on operations consisting of drilling and completions, re-completions, workovers and abandonment and international pursuits, and to the Company's continued commitment to an active drilling program. The breakdown of these capital expenditures for 2004 was, domestic expenditures of $3,656,010 and international expenditures of $1,312,821. Comparative numbers for the same period of 2003 were, domestic expenditures of $3,816,797 and international expenditures of $694,528. In the first quarter of 2004, the Company sold a non-core, non-producing asset at Buckinghorse in northeastern British Columbia for proceeds of $877,500.

Liquidity and Capital Resources

At December 31, 2004 International Sovereign's market value of common shares was $27,553,054 based on the closing price of $3.10 per share times 8,888,082 shares outstanding. This compares to a market value of $11,858,730 at the end of December 31, 2003 based on the closing price of $1.67 per share and 7,101,036 shares outstanding. Cash flow from operations was $3,059,782, down 19% from $3,769,673 at the end of the corresponding period of 2003. This equated to a decrease

from $0.56 per basic weighted share in 2003 to $0.39 per basic weighted share in 2004. This decrease is primarily attributable to decreased revenue, increased operating costs, increased general and administrative costs, as well as a substantial increase in the number of outstanding shares in the period ending December 31, 2004, as compared to the corresponding period in 2003. Cash flow from operations is provided to assist management and investors in determining the ability of the Company to generate cash from operations. It is calculated from the consolidated statements of operations as net earnings adjusted for items that do not affect cash. This measure does not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies.

At the end of December 2004, International Sovereign had an undrawn operating line of credit of $4,150,000 and no long-term debt. In comparison, at the end of December 2003 the Company had an undrawn operating line of credit of $4,400,000 and no long-term debt.

Stock Based Compensation and Other Stock Based Compensation

As of January 1, 2003 the Company elected to adopt on a prospective basis the fair-value based method of accounting for stock options as recommended in section 3870 of the Canadian Institute of Chartered Accountants ("CICA") handbook. Under this method the Company recognizes stock compensation expense based on the estimated fair value of the option on the date of grant, which is determined using the Black-Scholes option-pricing model. The fair value of the options is recognized over the vesting period of the options granted as stock compensation expense and contributed surplus. The contributed surplus balance is reduced as the options are exercised and the amount initially recorded is credited to share capital. No stock compensation expense is recorded for stock options granted and outstanding prior to January 1, 2003.

Using the fair value method of accounting for stock options issued to employees on or after January 1, 2003, the Company recognized compensation expense in the consolidated statement of earnings, with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the year ended December 31, 2004. No options were granted during the year ended December 31, 2003.

On July 29, 2004 the Company closed a private placement with both arm's length and non-arm's length parties. The Company issued 1,617,621 common shares at a price of $1.50 per share, for aggregate proceeds of $2,426,431. Net proceeds of the offering, after all costs net of tax, were $2,225,174. The agent for the issue is entitled to purchase 161,762 common shares of the Company as a compensation warrant at any time until July 27, 2005, on payment of $1.65 per warrant. The fair value of each warrant granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends were paid on common shares, a risk free interest rate of 5.5% on an average life of one year and a volatility of 53%. For these warrants the Company recognized a $20,121 decrease to share capital (included in issue costs, net of tax) and a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004. As of December 31, 2004 no agents warrants were exercised.

On June 12, 2004 the Company issued 110,000 options at an exercise price of $1.60. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 5.5% on an average life of five years and a volatility of 51%. For these options the Company recognized $9,898 of compensation expense in the Consolidated Statement of Earnings, with a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004.

On November 9, 2004 the Company issued 25,000 options at an exercise price of $2.05. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 5.5% on an average life of five years and a volatility of 52%. For these options the Company recognized $762 of compensation expense in the Consolidated Statement of Earnings, with a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004.

The amounts computed according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holder.

Contractual Obligations

As part of normal operations, International Sovereign is a party to various financial guarantees, letters of credit and other contractual commitments. Oil sales from Company production are contracted on a month-to-month evergreen basis and gas sales from Company production are contracted on an annual basis commencing each November. International Sovereign also has a letter of credit outstanding totaling $7,500 to maintain its status as a licensed

well operator in the province of British Columbia. The Company also has a legal obligation to reclaim the lands on which they have production wells and/or facilities. These obligations come due at varying times, dependent upon when economic production ceases and the property is then available for abandonment and reclamation operations.

Transactions with Related Parties

At December 31, 2004 accounts payable of $20,631 (2003 – $20,852) include balances owing to a company, which has a director in common with the Company. Accounts receivable of $29,642 (2003 – $80,629) include balances owing from a company which has an officer in common with the Company. During the period January 1 to June 9, 2004 the Company paid $43,484 (2003 – $85,525) for legal services in the normal course of business to a law firm of which the partner was an officer of the Company. Also, on March 1, 2003, the Company sold a minor interest property to a corporation which has an officer in common with the Company, for a consideration of $46,000. These transactions were incurred in the normal course of operations on similar terms and conditions to those entered into with unrelated parties. These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Business Risks

The oil and gas industry is subject to numerous risks, including commodity prices, interest rates, exchange fluctuations, as well as environmental concerns and the success of future drilling. International Sovereign attempts to reduce and manage those risks which are controllable.

Safety and Environmental

Safety and environmental concerns are addressed through a corporate contingency plan and by continued emphasis on complying with environmental regulations.

Critical Accounting Estimates

The preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates. Due to the timing of when activities occur compared to the reporting of those activities, management estimates and accrues operating results and capital spending. Changes in these judgments and estimates could have a material impact on the Company's financial results and financial condition.

Depletion

The Company accounts for oil and gas properties using the full-cost method of accounting. Under this method, depletion and restoration expenses are recorded using the unit-of-production method. All costs related to exploration and development of oil and gas reserves are capitalized on a country by country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Depletion is an estimate of the reduction in recoverable costs of oil and gas properties during the year, matched against the related income. It is based on reserve estimates, which are evaluated by an independent third party. The determination of the quality and quantity of recoverable reserves is also an area of risk. Oil and gas reserves are integral to assessing expected future financial performance, preparing financial statements and making investment decisions. There are numerous uncertainties inherent in estimating quantities of proved oil and natural gas reserves, including many factors beyond the Company's control. The reserves used in calculating depletion and impairment of capital assets represent estimates only.

International Sovereign mitigates this risk by having the reserves evaluation performed by a reputable third party consultant. The Company's Reserves Committee of the Board of Directors reviews the work and independence of this firm.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are initially excluded from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

Effective January 2004 the new full cost accounting guideline for the oil and gas industry (AcG 16 – "Oil and Gas Accounting Full Cost") was implemented. This guideline provides new guidance in conducting the ceiling test on oil and gas assets. The new ceiling test requires management to determine a fair value of the oil and gas assets. This is determined by estimating the present value of future escalated cash flows based on management's best estimate of the future operating environment using proved reserves. The old ceiling test (under AcG 5 – Full Cost Accounting in the Oil and Gas Industry) determined the recoverable amount of capital assets to be the undiscounted future value of cash flows based on year end estimates using total proved reserves.

Given the significant assumptions required and the possibility that actual conditions will differ, International Sovereign considers the assessment of impairment to be a critical accounting estimate. A change in this estimate would impact the Company's business. It is difficult to determine and assess the impact of a decrease in proved reserves on our impairment tests. The relationship between the reserve estimate and the estimated undiscounted cash flows is complex. As a result, the Company is unable to provide a reasonable sensitivity analysis of the impact that a reserve estimate decrease would have on its assessment of impairment. The Company does however, have confidence in its reserve estimates. In addition, the price forecasts used to determine the fair value are based on publicly posted pricing forecasts of reputable reserves evaluation firms. The Company has now adopted this new guideline. There were no changes to net income, PP&E or any other reported amounts in the consolidated financial statements as a result of adopting this guideline.

Asset Retirement Obligation (Site Restoration)

In January 2004 the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented for comparative purposes. This new standard requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair market value, which is the discounted future value of the liability. This liability accretes until the date of expected settlement of the retirement obligations.

Previously, International Sovereign recognized a provision for future site reclamation and abandonment costs calculated on the unit-of-production method over the life of the petroleum and natural gas properties based on total estimated proved reserves and the estimated future liability. See the previous note in this MD&A regarding Asset Retirement Obligation for the impact of this change of methodology on the Company.

Future Income Taxes

The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Future income tax expense is computed based on the change during the year in the future tax assets and liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary tax differences are expected to reverse effects of changes in tax laws, and tax rates are recognized when enacted. For the period ended December 31, 2004 this future income tax expense was calculated to be ($33,777) compared to $142,054 at the end of the corresponding period in 2003.

Reserves Disclosure

The process of estimating reserves is critical to several accounting estimates. It requires significant judgments based on available geological, geophysical, engineering and economic data. These estimates may change substantially as data from ongoing development and production activities becomes available, and as economic conditions impacting oil and gas prices, operating costs and royalty burdens change. Reserve estimates impact net income through depletion, the determination of asset retirement obligations and the application of an impairment test. Revisions or changes in the reserve estimates can have either a positive or a negative impact on net income and the asset retirement obligation.

Where any disclosure of reserves data is made in this MD&A that does not reflect all reserves of the Company, it should be noted that the estimates of reserves and future net revenue for individual properties or groups of properties may not reflect the same confidence level as estimates of reserves and future net revenue for all properties. Any reference to "established reserves" has the meaning of the January 1, 2003, COGE (Canadian Oil and Gas Evaluation) Handbook, proved plus 50% of probable reserves, which is similar but not identical to the January 1, 2004 definition of proved plus probable reserves.

Impact of New Accounting Pronouncements

During 2003 and 2004 the following new or amended standards and guidelines were issued by the Canadian Institute of Chartered Accountants (CICA) and Canadian Securities regulatory authorities.

Hedging Relationships

Accounting Guidelines 13 (AcG 13) "Hedging Relationships"), which is effective for fiscal years beginning on or after July 1, 2003, addresses identification, designation, documentation and effectiveness requirements of financial instruments to qualify for hedge accounting. It also establishes conditions for applying or discontinuing hedge accounting. Under this new guideline, hedging transactions must meet a strict set of criteria to continue to apply accrual accounting for positions hedged.

If this criteria is not met, the transaction must be accounted for using mark-to-market accounting as described in EIC 128 – Accounting for Trading, Speculative, or Non-hedging Derivative Financial Instruments, which has the same effective date as AcG 13. International Sovereign has no hedging relationships in place in 2004, nor did the Company in 2003.

Impairment of Long-lived Assets

In December 2002, the CICA issued a new standard on the impairment of long-lived assets, which is effective for years beginning on or after April 1, 2003. The new standard requires an impairment loss for long-lived asset to be held and used to be recognized when its carrying amount exceeds the sum of the undiscounted cash flows expected from its use and eventual value, and provides guidance on how to determine fair value.

Stock Based Compensation and Other Stock Based Payments

In September 2003, the CICA issued an amendment to section 3870 "Stock based compensation and other stock based payments". The amended section is effective for fiscal years beginning on or after January 1, 2004, however, earlier adoption is recommended. The amendment requires that companies measure all stock based payments using the fair value method of accounting and recognize the compensation expense in their financial statements. International Sovereign implemented this amended standard in 2003 in accordance with the early adoption provisions. Early adoption requires that compensation expense be calculated and recorded in the income statement for options issued on or after January 1, 2003. Prior to the implementation of this standard, only pro-forma disclosure of this impact was required. See previous discussion under Stock Based Compensation in this MD&A for impact on the Company's financial statements.

Disposal of Long-lived Assets and Discontinued Operations

In December 2002, the CICA issued a new standard on the disposal of long-lived assets and discontinued operations, which is effective for disposal activities initiated by a company's commitment to a plan on or after May 1, 2003. The new standard requires an asset classified as held for sale to be measured at fair value less cost to sell, provides criteria for classifying assets as held for sale and classifying a disposal as discontinued operations, and specifies presentations and disclosures for discontinued operations and other disposals of long-lived assets.

Asset Retirement Obligations

Canadian Institute of Chartered Accountants (CICA) issued a new standard on the accounting for asset retirement obligations. This standard requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the date of expected settlement of the retirement obligations. The new standard is effective for all fiscal years beginning on or after January 1, 2004. The Company has adopted this policy in the first quarter of 2004, the results of which have been discussed earlier in this MD&A.

Oil and Gas Accounting – Full Cost

In 2003, Accounting Guideline 16 "Oil and Gas Accounting – Full Cost" was issued to replace CICA Accounting Guideline 5. The new guideline amends the ceiling test calculation applied by the Company to its oil and gas assets. AcG 16 is effective for fiscal years beginning on or after January 1, 2004. Had International Sovereign adopted this guideline in 2003 it would not have changed the result of the ceiling test. The Company did adopt this guideline in the first quarter of 2004, and there were no changes to net income, PP&E or any other reported amounts in the consolidated financial statements as a result of adopting this guideline.

Disclosure of Guarantees

In February 2003, The CICA issued Accounting Guideline 14 "Disclosure of Guarantees" which requires that all guarantees be disclosed in the notes to the financial statements along with a description of the nature and term of the guarantee and estimate of the fair value of the guarantee. The new guideline is effective for fiscal years beginning on or after January 1, 2003. Implementation of this new guideline did not impact the Company's results for 2003, nor in the year ending December 31, 2004.

Generally Accepted Accounting Principles and Standard of Financial Statement Presentation

In 2003, the CICA re-issued handbook section 1100 "Generally Accepted Accounting Principles" and 1400 " General Standards of Financial Statements Presentation". The amendments are effective for fiscal periods on or after October 1, 2003 on a prospective basis. The most significant amendment has been the elimination of looking to industry practice in areas where Canadian GAAP is silent. Instead, entities are encouraged to seek out other accounting bodies with specific guidance first.

Continuous Disclosure Obligations

Effective March 31, 2004 International Sovereign was subject to new disclosure requirements as preset forth in National Instrument 51-102 "Continuous Disclosure Obligations". This new instrument is effective for fiscal years beginning on or after January 1, 2004. The instrument provides for shorter reporting periods for filing of annual and interim financial statements, MD&A and Annual Information Forms ("AIF"). The instrument also provides for enhanced disclosure in the annual and interim financial statements, MD&A and AIF. Under its new instrument, it will no longer be mandatory for the Company to mail annual and interim financial statements and MD&A to shareholders. Instead, these documents will be provided on an "as requested" basis. International Sovereign had early adopted the expanded MD&A disclosures at December 31, 2003.

Earnings per Share

In July 2004 the CICA proposed to amend Handbook Section 3500 "Earnings per Share" to reflect similar amendments adopted by the International Accounting Standards Board. The majority of the amendments relate to the treatment of mandatory convertible instruments. The CICA expects changes to be effective for interim and annual periods relating to fiscal years beginning on or after January 1, 2005. The Company currently does not have any mandatory convertible instruments and therefore does not expect these amendments to have a material impact on the Company.

Financial Instruments – Recognition and Measurement, Hedges, and Comprehensive Income

The Accounting Standards Board ("AcSB") has issued three exposure drafts on financial instruments which will apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. It will require the following:

- all trading financial instruments will be recognized on the balance sheet and will be fair valued through the income statement;
- all remaining financial assets will be recorded at cost and amortized through the financial statements;
- a new statement for comprehensive income that will include certain gains and losses on translation of assets and liabilities; and
- an update to AcG-13 to incorporate the fair value changes not recorded in the income statement to be recorded through the comprehensive income statement.

The Company has not assessed the future impact on the financial statements at this time.

Changes in Accounting Policies and Estimates and Errors

The AcSB has proposed a new Handbook section 1506 "Changes in accounting policies and estimates, and errors" to provide guidance around when and how an entity is permitted to change an accounting policy as well as establish appropriate disclosures to explain the effects of changes in accounting policy, estimates and corrections of errors.

Subsequent Events

The AcSB has proposed to extend the period during which subsequent events are required to be considered. This period is between the balance sheet date and when the financial statements are authorized for issue. Furthermore, disclosure is required as to the date the financial statements were authorized for issue and who provided that authorization.

Other accounting standards issued by the CICA during the year ended December 31, 2004 are not expected to materially impact the Company.

Outlook

International Sovereign is anticipating an active 2005. The Company will participate as to its working interests, ranging from 39% to 50% in the completion of three wells in the Lacombe/Chigwell area in the first quarter of the year. Additionally, the Company will participate in the completion of a recently drilled well in the Ante Creek area of Alberta in which the Company holds a 25% working interest. All four of these wells have been recently cased. Production from successful completions on these wells should commence in the first and second quarters of the year.

In Medicine River, the twinning of an existing producer for uphole potential from two additional zones (~46.5% working interest) and the re-completion of an existing marginal producer (~63% working interest) for Glauconite zone potential is expected to occur after spring breakup. Also in Medicine River, the Company expects to drill in the second half of 2005 a 100% working interest Devonian test, with indicated gas and oil reserves in both the Nisku and Leduc zones. A 10 km sour gas pipeline will be required to tie-in the newly drilled well, as well as a second, ~50% interest Leduc well that has tested gas at rates up to 6.0 MMcfd. The Company expects production from these wells in the fourth quarter 2005.

The Company has also generated several Mannville prospects in the general Wizard Lake area of central Alberta. Seismic and land acquisition and negotiations are proceeding, and field activity on these prospects should commence as early as the second quarter of 2005.

On the international front, the Company's negotiations with PetroEcuador to reform the terms of the work program of the Charapa concession are at an advanced stage. Upon final agreement, the Company plans to commence a 3D seismic survey followed by a horizontal re-entry operation into the Hollin formation from an existing wellbore in the Charapa field.

In Pakistan, the Company executed a Memorandum of Agreement with the Oil & Gas Development Company Limited for the exploitation of the upper carbonate zones in the Toot oil field located in the Potwar region. The technical studies associated with Stage 1 of the project are underway.

Subsequent Events

On January 5, 2005 the Company announced that a Memorandum of Agreement has been signed with Oil and Gas Development Company Limited, the national oil company of Pakistan, for the exploitation of the upper carbonate zones in the Toot oil field located in the Potwar region, Punjab Province, which is near the capital city of Islamabad.

On February 22, 2005 the Company closed a private placement consisting of 2,069,000 common shares at a price of $3.00 per share for gross proceeds of $6,207,000. The agent for the private placement was paid a cash commission equal to 7% of the proceeds of the private placement. Net proceeds after all commissions and costs were $5,727,510. In addition the agent and its sub-agents were issued compensation warrants to acquire up to an aggregate of 206,900 common shares exercisable for a period of two years at an exercise price of $3.35 per share. All the shares issued are subject to a four months hold period expiring June 23, 2005.

Summary Fourth Quarter Information

In comparing the fourth quarter of 2004 with the same period in 2003, net income decreased from a loss of $287,327 in the fourth quarter of 2003 to a loss of $530,468 in Quarter 4, 2004. This was largely the result of an increase of depletion from $803,121 in 2003 to $1,135,608 in the fourth quarter of 2004, due to an increased depletion rate on domestic assets and international writedowns in Azerbaijan and Pakistan. Average production dropped from 789 boe/d to 451 boe/d largely because of the Marwayne production loss previously in this report. However, cash flow increased from $314,098 in Quarter 4, 2003 to $447,498 at the end of Quarter 4, 2004 due to higher commodity prices, despite decreased production, and lower G&A costs in the fourth quarter of 2004 from $476,029 in 2003 to $407,943 in 2004.

Annual and Quarterly Information

2004 Quarterly Information	Qtr1	Qtr2	Qtr3	Qtr4	Annual
	$	$	$	$	$
Gross Revenues after Royalties	1,886,107	1,403,559	1,557,463	1,300,089	6,147,218
Total Assets	15,311,492	15,374,374	17,778,055	17,658,946	17,658,946
Cash Flow from Operations	1,089,093	734,434	788,757	447,498	3,059,782
Basic Per Share	0.15	0.11	0.09	0.04	0.39
Diluted Per Share	0.13	0.11	0.09	0.02	0.35
Net Income	405,978	307,389	158,613	(530,468)	341,512
Basic Per Share	0.06	0.04	0.02	(0.08)	0.04
Diluted Per Share	0.05	0.04	0.02	(0.07)	0.04

2003 Quarterly Information	Qtr1	Qtr2	Qtr3	Qtr4	Annual
	(Restated) $	(Restated) $	(Restated) $	(Restated) $	(Restated) $
Gross Revenues after Royalties	1,882,356	1,526,246	1,772,671	1,714,410	6,895,683
Total Assets	12,427,983	13,007,811	13,899,617	15,248,961	15,248,961
Cash Flow from Operations	1,365,494	1,011,970	1,078,111	314,098	3,769,673
Basic Per Share	0.21	0.16	0.16	0.03	0.56
Diluted Per Share	0.21	0.15	0.15	0.01	0.52
Net Income	773,490	549,468	356,850	(287,327)	1,392,481
Basic Per Share	0.12	0.09	0.05	(0.06)	0.20
Diluted Per Share	0.11	0.09	0.05	(0.07)	0.18

2002 Quarterly Information	Qtr1	Qtr2	Qtr3	Qtr4	Annual
	$	$	$	$	$
Gross Revenues after Royalties	828,359	1,518,515	1,350,541	1,428,925	5,126,340
Total Assets	11,214,362	11,687,667	11,953,031	12,003,481	12,003,481
Cash Flow from Operations	449,724	1,001,167	832,030	609,098	2,892,019
Basic Per Share	0.07	0.16	0.13	0.09	0.45
Diluted Per Share	0.07	0.15	0.13	0.09	0.44
Net Income	138,971	607,045	181,033	(165,228)	761,821
Basic Per Share	0.02	0.09	0.03	(0.02)	0.12
Diluted Per Share	0.02	0.09	0.03	(0.02)	0.12

For the purpose of cash flow per share calculations, cash flow is defined as "Cash flow from operations" before the charges in non-cash working capital. This definition is not a recognized measure under Canadian generally accepted accounting principles and accordingly may not be comparable to measure used by other companies.

FINANCIAL INFORMATION

Management's Report

To the Shareholders of International Sovereign Energy Corp.

The information contained in this annual report and the accompanying financial statements and other financial information as well as the reporting process that produces such statements is the responsibility of Management.

Management maintains a system of internal controls designed to reasonably assure that transactions are appropriately authorized, that relevant and reliable financial information is produced in a timely manner and that the assets of the Corporation are adequately safeguarded.

The Management of the Company has the responsibility for the integrity and objectivity of the information contained in this annual report and to ensure that the operating information presented throughout this annual report is consistent with that shown in the financial statements, which are prepared by Management in accordance with generally accepted accounting principles.

The external auditors, appointed by the shareholders of the company have examined the financial statements in order to provide an independent view as to the fairness of reported operating results and financial condition.

The Audit Committee of the Board of Directors that consists primarily of non-management directors have reviewed the financial statements including notes thereto, with Management and has reported to the Board of Directors.

The financial statements, upon the recommendation of the Audit Committee, have been approved by the Board of Directors.

Lutfur Rahman Khan
Chief Executive Officer

Omair Choudhry
Chief Financial Officer

Calgary, Alberta
March 11, 2005

Auditors' Report

To the Shareholders of International Sovereign Energy Corp.

We have audited the consolidated balance sheets of International Sovereign Energy Corp. (the "Company") as at December 31, 2004 and 2003 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Calgary, Alberta
March 11, 2005

Chartered Accountants

Consolidated Balance Sheets

As at December 31,	2004 $	2003 $ (Note 3)
ASSETS		
CURRENT		
Cash	**1,457,092**	409,994
Accounts receivable	**1,077,505**	1,141,990
Prepaid expenses and deposits	**2,500**	2,500
	2,537,097	1,554,484
Property and equipment (Note 4)	**15,121,849**	13,694,477
	17,658,946	15,248,961
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	**1,403,751**	1,690,593
Operating loan (Note 6)	**–**	–
	1,403,751	1,690,593
Future income tax liability (Note 7)	**2,843,179**	2,966,982
Asset retirement obligation (Note 5)	**714,004**	600,182
	4,960,934	5,257,757
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	**9,028,249**	6,693,734
Contributed Surplus (Note 8)	**30,781**	–
Retained earnings	**3,638,982**	3,297,470
	12,698,012	9,991,204
	17,658,946	15,248,961

Approved by the board

Director

Director

Consolidated Statements of Operations and Retained Earnings

For the Years Ended December 31,	2004 $	2003 $
		(Note 3)
REVENUE		
Petroleum and natural gas revenues (Note 3)	**7,109,199**	7,977,939
Royalties, net of ARTC	**(988,285)**	(1,088,134)
Other income	**26,304**	5,878
	6,147,218	6,895,683
EXPENSES		
Operating costs	**1,710,637**	1,654,568
Transportation costs (Note 3)	**76,384**	60,223
General and administrative	**1,322,207**	1,196,771
Interest	**810**	6,675
Depletion, depreciation and accretion (Note 5)	**2,741,387**	2,235,138
Stock-based compensation expense (Note 8)	**10,660**	–
	5,862,085	5,153,375
EARNINGS BEFORE INCOME TAXES	**285,133**	1,742,308
INCOME TAXES (Note 7)		
Current	**(22,602)**	207,773
Future	**(33,777)**	142,054
	(56,379)	349,827
NET EARNINGS (Note 10)	**341,512**	1,392,481
RETAINED EARNINGS, BEGINNING OF YEAR		
As previously reported	**3,255,289**	1,872,094
Change in accounting policy (Note 3)	**42,181**	32,895
RETAINED EARNINGS, END OF YEAR	**3,638,982**	3,297,470

Consolidated Statements of Cash Flows

For the Years Ended December 31,	2004 $	2003 $ (Note 3)
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES:		
OPERATING		
Net earnings	**341,512**	1,392,481
Adjustments for:		
Depletion, depreciation and accretion	**2,741,387**	2,235,138
Stock-based compensation expense	**10,660**	–
Future income taxes	**(33,777)**	142,054
	3,059,782	3,769,673
Asset retirement costs incurred	**(4,779)**	(21,776)
	3,055,003	3,747,897
Changes in non-cash working capital		
Accounts receivable and prepaid expenses and deposits	**259,991**	(538,997)
Accounts payable and accrued liabilities	**(550,640)**	852,854
	2,764,354	4,061,754
FINANCING		
Issuance of common shares	**2,155,269**	459,000
Exercise of stock options	**61,769**	–
Exercise of warrants	**47,572**	–
	2,264,610	459,000
INVESTING		
Additions to property and equipment	**(4,968,831)**	(4,511,325)
Proceeds on sale of property and equipment	**918,672**	141,830
	(4,050,159)	(4,369,495)
Changes in non-cash working capital		
Accounts receivable and prepaid expenses and deposits	**(195,505)**	–
Accounts payable and accrued liabilities	**263,798**	245,678
	(3,981,866)	(4,123,817)
NET INCREASE IN CASH	**1,047,098**	396,937
CASH, BEGINNING OF YEAR	**409,994**	13,057
CASH, END OF YEAR	**1,457,092**	409,994

SUPPLEMENTARY INFORMATION		
Cash taxes paid	**–**	29,301
Cash interest paid	**810**	6,675

Notes to the Consolidated Financial Statements

For the Years ended December 31, 2004 and 2003

1. NATURE OF BUSINESS

International Sovereign Energy Corp., and its wholly-owned subsidiary (the "Company") are in the business of exploration for and development of petroleum and natural gas interests.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles.

Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary incorporated in Ecuador.

Comparative figures

Certain comparative figures have been reclassified to the current period's presentation.

Cash and cash equivalents

Cash and cash equivalents include cash and short-term investments with a maturity of 90 days or less at the time of issue.

Property, plant and equipment

The Company follows the full cost method of accounting for oil and gas operations as prescribed by the Canadian Institute of Chartered Accountants ("CICA"). All costs related to exploration and development of oil and gas reserves are capitalized on a country by country basis. Such costs include lease acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties, costs of drilling productive and non-productive wells and overhead charges related directly to acquisition, exploration and development activities.

Costs of acquiring and evaluating unproven properties in Canada and costs of exploration and land in international cost centers are excluded initially from costs subject to depletion, until it is determined whether or not proved reserves are attributable to the properties or, in the case of major development projects, commercial production has commenced, or impairment has occurred. Impairment occurs whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. When proven reserves are determined or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion for that country's cost centre. Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss will be recorded.

The net carrying value of the Company's petroleum and natural gas properties for each country is limited to an ultimate recoverable amount. This is determined by estimating the present value of future escalated cash flows based on management's best estimate of the future operating environment using proved reserves. Future net revenues are estimated using future price forecasts.

For each cost center, the capitalized costs associated with proven reserves, including the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated proven reserves before royalties, determined by independent petroleum engineers. Oil and gas reserves and production are converted into equivalent units based upon estimated relative pricing content at a ratio of six thousand cubic feet of gas to one barrel of oil.

Asset retirement obligation

The Company recognizes as a liability the estimated fair value of the future retirement obligations associated with property, plant and equipment. The fair value is capitalized and amortized over the same period as the underlying asset. The Company estimates the liability based on the estimated costs to abandon and reclaim its net ownership interest in all wells and facilities and the estimated timing of the costs to be incurred in future periods. This estimate is evaluated on a periodic basis and any adjustment to the estimate is prospectively applied. As time passes, the change in net present value of the

future retirement obligation is expensed through accretion. Retirement obligations settled during the period reduce the future retirement liability.

Revenue recognition

Petroleum and natural gas revenues are recognized when the commodities are sold and title passes to the customer.

Joint venture accounting

A portion of the Company's exploration and production activities is conducted jointly with others and, accordingly, these consolidated financial statements reflect only the Company's proportionate interest in such activities.

Financial instruments

The carrying values of cash, deposits, accounts receivable and accounts payable and accrued liabilities approximate the fair values of these financial instruments due to the short-term nature of these instruments.

Foreign currency translation

Transactions of the Company and its subsidiary that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction dates. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates at the balance sheet date. Exchange gains and losses arising on the translation of monetary assets and liabilities are included in the determination of income for the year.

Stock-based compensation plan

As of January 1, 2003 the Company elected to adopt on a prospective basis the fair-value based method of accounting for stock options as recommended in section 3870 of the Canadian Institute of Chartered Accountants ("CICA") handbook. Under this method the Company recognizes stock compensation expense based on the estimated fair value of the option on the date of grant, which is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period of the options granted as stock compensation expense and contributed surplus. The contributed surplus balance is reduced as the options are exercised and the amount initially recorded is credited to share capital. No stock compensation expense is recorded for stock options granted and outstanding prior to January 1, 2003.

Future income taxes

The Company accounts for future income taxes using the liability method. Future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax bases. Income tax expense (recovery) is computed based on the change during the year in the future tax assets and liabilities. Future income tax liabilities or assets are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Effects of changes in tax laws and tax rates are recognized when enacted.

Earnings per share

Basic earnings per common share is calculated using the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the year plus the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method.

3. CHANGES IN ACCOUNTING POLICIES

Asset retirement obligation

In January 2004 the Company adopted CICA Handbook Section 3110 "Asset Retirement Obligations". This change in accounting policy has been applied retroactively with restatement of prior periods presented for comparative purposes. This standard requires recognition of a liability for the future retirement obligations associated with property, plant and equipment. These obligations are initially measured at fair value, which is the discounted future value of the liability. The liability accretes until the date of expected settlement of the retirement obligations. The new standard is effective for all fiscal years beginning on or after January 1, 2004.

Previously, the Company recognized a provision for future site reclamation and abandonment costs calculated on the unit-of-production method over the life of the petroleum and natural gas properties based on total estimated proved reserves and the estimated future liability.

As a result of this change net earnings for the year ended December 31, 2003 increased by $9,286 ($16,838, net of a future income tax expense of $7,552). The Asset Retirement Obligation ("ARO") increased by $43,410, property, plant and equipment ("PP&E") net of accumulated depletion increased by $60,249 and the future income tax liability increased by $7,552. Opening 2003 accumulated earnings increased by $32,895 ($51,023, net of a future income tax expense of $18,128) to reflect the cumulative impact of accretion and depletion expense, net of the cumulative site restoration provision, on the asset retirement obligation recorded retroactively to 1994. The opening ARO in 2003 increased by $234,779.

For the year 2004 the ARO increased by $113,822, ($118,601 less actual abandonment costs of $4,779), PP&E increased $55,369 net of depletion, and net income decreased $104,056 to reflect the impact of accretion and depletion expense for the year.

Oil and gas accounting full cost

Effective January 1, 2004 the new full cost accounting guideline for the oil and gas industry (AcG 16 – "Oil and Gas Accounting Full Cost") was adopted by the Company. This guideline provides new guidance in conducting the ceiling test on oil and gas assets. The new ceiling test requires management to determine a fair value of the oil and gas assets. This is determined by estimating the present value of future escalated cash flows based on management's best estimate of the future operating environment using proved reserves. The old ceiling test (under AcG 5 – Full Cost Accounting in the Oil and Gas Industry) determined the recoverable amount of capital assets to be the undiscounted future value of cash flows based on year end estimates using total proved reserves.

Stock-based compensation plan

Effective January 1, 2003, the Company elected to prospectively adopt the fair value method of accounting for options granted subsequent to January 1, 2003 under its stock-based compensation plan as recommended by the CICA. Compensation expense has been recognized in the consolidated statement of operations with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the years ended December 31, 2003 and 2004, using the fair value method. Previously, the Company accounted for this stock-based compensation using intrinsic values as defined by the CICA and accordingly, did not recognize compensation expense in the consolidated financial statements for share option granted to employees and directors when issued at market value.

Oil and gas transportation

Effective for fiscal years beginning on or after October 1, 2003, the CICA issued Handbook Section 1100, which defines the sources of GAAP that companies must use and effectively eliminates industry practice as a source of GAAP. In prior years, it had been industry practice for companies to net transportation charges against revenue rather than showing transportation as a separate expense on the income statement. Effective December 31, 2004, the Company has recorded revenue before transportation charges and transportation expense on the statement of operations. Prior periods have been reclassified for comparative purposes. This adjustment has no impact on net earnings or net earnings per share for either year.

4. PROPERTY AND EQUIPMENT

	2004	2003
	$	$
		(Note 3)
Petroleum and natural gas properties	**25,236,431**	21,119,580
Furniture and equipment	**267,747**	261,806
	25,504,178	21,381,386
Less: accumulated depletion and depreciation	**10,382,329**	7,686,909
	15,121,849	13,694,477

During the year, the Company capitalized general and administrative expenditures of $1,455,321 (2003 – $770,778) related to both Canadian and international exploration and development activities.

Costs of $4,053,018 related to undeveloped properties were not subject to depletion during year ended December 31, 2004 (2003 – $2,740,197). For the year ended December 31, 2004 capitalized costs of $787,254 in Pakistan and Azerbaijan (2003 – $461,563 in Pakistan, Morocco, Angola and Russia) related to the impairment of certain international cost centers have been charged to depletion.

For purposes of arriving at the values of the estimated future cash flows under the oil and gas full cost guidelines (revenues, net of royalties, operating costs, capital costs and abandonment costs), the following price forecasts were used by the Company's independent petroleum engineers (Alberta Par Price $CDN/STB. Conversion from gas (MCF) to BOE equivalent = 6:1).

	Alberta Par Price[1] $CDN/STB	Alberta Heavy[2] $CDN/STB
2005	50.22	35.15
2006	49.00	34.30
2007	47.72	33.40
2008	45.15	31.61
2009	43.87	30.71

Each year thereafter the prices increase by 1.5% per year until the year 2020.

Individual properties may have transportation and quality adjustments made to these prices by the evaluator.

(1) Equivalent price for Light Sweet Crude (D2/S2) landed in Edmonton, Alberta after exchange of 0.82$US/$CDN(2005), 0.80$US/$CDN(2006) and 0.78$US/$CDN thereafter and transportation differential of $1.00 CDN/STB.

(2) Bow River at Hardisty, Alberta (905 kg/m^3, 2.1% sulphur).

5. ASSET RETIREMENT OBLIGATION

Total future asset retirement obligations were estimated by management based on the Company's net ownership interest in wells and facilities, estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of its total asset retirement obligations to be $714,004 at December 31, 2004 compared to $600,182 at December 31, 2003 based on a total liability of $1,395,082 and $1,301,294 respectively. These payments are expected to be made over the next thirty years at varying times. The Company used a risk free and inflation rate of 7.0% to calculate the asset retirement obligations for both 2004 and 2003. Settlements during the year approximated our estimates and as a result, no gains or losses were recognized.

Following is a reconciliation of the asset retirement obligations:

		2004		2003
Asset retirement obligations, beginning of year	$	**600,182**	$	446,770
Increase in estimated retirement obligations		**72,632**		136,633
Retirement obligations settled		**(4,779)**		(21,776)
Accretion expense		**45,969**		38,555
Asset retirement obligations, end of year	$	**714,004**	$	600,182

6. OPERATING LOAN

During the year ended December 31, 2004, the Company secured a revolving line of credit to a maximum of $4,150,000. The operating loan bears interest at prime plus 0.75% and is secured by a demand debenture for a minimum of $5,000,000, providing a floating charge over all assets of the Company, and a letter of undertaking not to encumber or dispose of assets, other than in the normal course of business, without the consent of the Bank, and to provide security under section 426 of the Bank Act and/or assign natural gas contracts. At December 31, 2004, there was no balance outstanding with respect to this facility (2003 – Nil). In addition, the lender has issued on behalf of the Company letters of credit totaling $7,500 (2003 – $7,500) to maintain its status as a licensed well operator in the province of British Columbia.

7. FUTURE INCOME TAXES

The provision for taxes varies from the amounts that would be computed by applying the effective Canadian federal and provincial income tax rates to earnings before income taxes as shown below:

	2004 $	2003 $
Earnings before income taxes	**285,133**	1,742,308
Corporate income tax rate	**38.87%**	40.74%
Computed income tax provision	**110,831**	709,816
Increase (decrease) resulting from:		
Non-deductible crown charges, net of ARTC	**176,788**	326,946
Taxable resource allowance	**17,754**	5,051
Resource allowance	**(47,885)**	(212,420)
Attributed Canadian royalty income	**(64,077)**	(56,502)
Non-deductible expenses	**9,138**	3,341
Impact of changes in effective tax rate	**(236,326)**	(432,359)
Income taxes recovered	**(22,602)**	–
Other	**–**	5,954
	(56,379)	349,827

The major components of the future income tax liability at December 31 using a combined federal and provincial rate of 33.70% (2003 – 36.20%) are as follows:

	Future Tax Liability	
	2004 $	2003 $
Taxable temporary differences:		
Carrying value in excess of tax basis	**3,019,897**	3,088,993
Attributed Canadian royalty income carryforward	**(176,718)**	(122,011)
Balance, December 31	**2,843,179**	2,966,982

8. SHARE CAPITAL

Authorized

Unlimited number of Class A common voting shares

Unlimited number of Class B common non-voting shares

Unlimited number of Class A preferred voting, 7%, non-cumulative, redeemable shares

	Number of Shares	Amount $
Class A common shares	6,445,323	**6,234,734**
Balance, December 31, 2002	6,445,323	**6,234,734**
Issuance of common stock (private placement)	655,713	**459,000**
Balance, December 31, 2003	7,101,036	**6,693,734**
Issuance of common stock (private placement)	1,617,621	**2,426,431**
Issue costs, net of tax	–	**(201,257)**
Exercise of stock options	116,567	**61,769**
Exercise of warrants	52,858	**47,572**
Balance, December 31, 2004	8,888,082	**9,028,249**

On July 29, 2004 the Company closed a private placement with both arm's length and non-arm's length parties. The Company issued 1,617,621 common shares at a price of $1.50 per share, for aggregate proceeds of $2,426,431. Net proceeds of the offering, after all costs net of tax, were $2,225,174. The agent for the issue is entitled to purchase 161,762 common shares of the Company as a compensation warrant at any time until July 27, 2005, on payment of $1.65 per warrant. The fair value of each warrant granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends were paid on common shares, a risk free interest rate of 5.5% on an average life of 1 year and a volatility of 53%. For these warrants the Company recognized a $20,121 decrease to share capital (included in issue costs, net of tax) and a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004. As of December 31, 2004, no agents warrants were exercised.

Stock option plan

Under the Company's stock option plan, the Company may grant options to its directors, officers and key employees to purchase Class A common shares ("Common Shares") from the Company at a fixed price not less than the fair market value of the stock on the day preceding the grant date. The Company has reserved 1,400,000 common shares for the grant of options. The options would vest equally over three years. The option's maximum term is five years.

	Options	Weighted Average Exercise Price $
As at December 31, 2002	584,667	0.55
Granted	–	–
Cancelled	–	–
Exercised	–	–
As at December 31, 2003	584,667	0.55
Granted	135,000	1.68
Cancelled	(25,000)	0.50
Exercised	(116,567)	0.53
As at December 31, 2004	578,100	0.82
Exercisable at December 31, 2004	384,766	0.54

The following table summarizes information about stock options outstanding at December 31, 2004:

Range of Exercise Price(s) $	Options Outstanding at December 31, 2004	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price $	Weighted Average at December 31, 2004	Weighted Average Exercise Price $
0.50	288,000	1.1	0.50	228,000	0.50
0.65	155,100	2.9	0.65	155,100	0.65
1.60	110,000	4.5	1.60	61,011	1.60
2.05	25,000	4.8	2.05	3,620	2.05
0.50 – 2.05	578,100			507,731	0.69

Accounting for Stock-Based Compensation

Using the fair value method of accounting for stock options issued to employees on or after January 1, 2003, the Company recognized compensation expense in the consolidated statement of earnings, with a corresponding increase recorded to contributed surplus in the consolidated balance sheet as at and for the year ended December 31, 2004. No options were granted during the year ended December 31, 2003.

On June 12, 2004 the Company issued 110,000 options at an exercise price of $1.60. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 5.5% on an average life of 5 years and a volatility of 51%. For these options the Company recognized $9,898 of compensation expense in the Consolidated Statement of Earnings, with a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004.

On November 9, 2004 the Company issued 25,000 options at an exercise price of $2.05. The fair value of each option granted by the Company was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free interest rate of 5.5% on an average life of 5 years and a volatility of 52%. For these options the Company recognized $762 of compensation expense in the Consolidated Statement of Earnings, with a corresponding increase recorded to contributed surplus in the Consolidated Balance Sheet as at December 31, 2004.

The amounts computed according to the Black-Scholes option pricing model may not be indicative of the actual values realized upon the exercise of these options by the holder.

9. RELATED PARTY TRANSACTIONS

At December 31, 2004 accounts payable of $20,631 (2003 – $20,852) include balances owing to a company, which has a director in common with the Company. Accounts receivable of $29,642 (2003 – $80,629) include balances owing from a company which has an officer in common with the Company. During the period January 1 to June 9, 2004 the Company paid $43,484 (2003 – $85,525) for legal services in the normal course of business to a law firm of which the partner was an officer of the Company. Also, on March 1, 2003, the Company sold a minor interest property to a corporation which has an officer in common with the Company, for a consideration of $46,000. These transactions were incurred in the normal course of operations on similar terms and conditions to those entered into with unrelated parties. These transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

10. EARNINGS PER COMMON SHARE

	2004	2003
Earnings per common share		
Basic	**$0.04**	$0.21
Diluted	**$0.04**	$0.19
Weighted average number of common shares		
Basic	**7,837,362**	6,709,405
Diluted	**8,692,692**	7,223,279

No options were excluded from diluted earnings per share as all the options were in the money in both 2004 and 2003.

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company is subject to normal industry credit risk on its accounts receivable with customers and joint venture partners. The Company mitigates these risks by only entering into agreements with credit worthy parties.

The Company is exposed to fluctuations in commodity prices for natural gas, crude oil and natural gas liquids. Commodity prices are affected by many factors including supply, demand and the Canadian to US dollar exchange rate. The Company's operating loan is also exposed to fluctuations in short-term Canadian interest rates. The Company has no financial hedges or fixed price commodity contracts in place at December 31, 2004.

The fair market value of financial instruments consisting of cash, deposits, accounts receivable, accounts payable and accrued liabilities approximate their carrying value due to their short-term nature. The operating loan bears interest at a floating market rate, accordingly, its carrying value approximates fair value.

12. COMMITMENT

The Company has committed to a lease for office premises expiring in August of 2006. The minimum annual payment required on the lease is $84,925.

13. SEGMENTED INFORMATION

The Company sells its petroleum and natural gas products to various purchasers. For 2004, three large integrated purchasers accounted of 43%, 27% and 11% (2003 – 57%, 9%, and 11%) of the Company's gross revenues.

The Company's core area of operation is in Canada. The Company is currently investigating opportunities in other countries. Total amount spent in 2004 on international activities was $1,312,821 (2003 – $694,528).

14. SUBSEQUENT EVENTS

On January 5, 2005 the Company announced that a Memorandum of Agreement has been signed with Oil and Gas Development Company Limited, the national oil company of Pakistan, for the exploitation of the upper carbonate zones in the Toot oil field located in the Potwar region, Punjab Province, which is near the capital city of Islamabad.

On February 22, 2005 the Company closed a private placement consisting of 2,069,000 common shares at a price of $3.00 per share for gross proceeds of $6,207,000. The agent for the private placement was paid a cash commission equal to 7% of the proceeds of the private placement. Net proceeds after all commissions and costs were $5,727,510. In addition the agent and its sub-agents were issued compensation warrants to acquire up to an aggregate of 206,900 common shares exercisable for a period of two years at an exercise price of $3.35 per share. All the shares issued are subject to a four months hold period expiring June 23, 2005.

Board of Directors
From Left To Right:
Qamar Malik,
Afzal Mahmood,
Lutfur Rahman Khan,
Desmond Smith,
Mahmood Arshad

Corporate Information

Directors

Lutfur Rahman Khan (2)(3)

Mahmood Arshad (1)(2)

Afzal Mahmood (1)(2)(3)

Qamar Malik, PhD. (1)

Desmond Smith(3)

(1) Member of the Audit Committee
(2) Member of the Compensation Committee
(3) Member of the Executive Committee

Officers

Lutfur Rahman Khan
President and Chief Executive Officer

Donald G. Campbell
Sr. Vice President Engineering
& Production and Chief Operating Officer

George P. Bowley
Sr. Vice President Exploration
& Development

Waseem Rahman
Sr. Vice President Administration
and Corporate Secretary

Omair Choudhry
Sr. Vice President Finance
and Chief Financial Officer

Executive Office, Vancouver

502, 815 Hornby Street
Vancouver, BC
Canada V6Z 2E6
Tel: (604) 684-7372
Fax: (604) 684-2407

Email: sovereign@isove.com
Web page: www.isove.com

Operations Office, Calgary

1750, 801 – 6th Avenue S.W.
Calgary, AB
Canada T2P 3W2
Tel: (403) 263-2472
Fax: (403) 264-7035

Overseas Office

No. 9 Street 40
Sector F – 7/1
Islamabad, Pakistan
Tel: 92-51-265 1732
Fax: 92-51-265 1731

Registrar and Transfer Agent

Valiant Trust Company
Calgary, AB

Banker

The Bank of Nova Scotia
Calgary, AB

Auditors

Deloitte & Touche LLP
Calgary, AB

Independent Engineers

Chapman Petroleum Engineering Ltd.
Calgary, AB

Legal Counsel

Timothy S. Hoar
ProVenture Law
Calgary, Alberta

Stock Exchange Listing

TSX Exchange
Symbol "ISR"

www.isove.com